

JPMORGAN CHASE & CO.

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May 1, 2014

Mr. Robert deV. Frierson,
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551

Email: regs.comments@federalreserve.gov

Re: Regulation CC Proposed Rule; Docket No. R-1409 and RIN No. 7100-AD68

Dear Mr. deV. Frierson:

JPMorgan Chase & Co., on behalf of its main subsidiary bank, JPMorgan Chase Bank, National Association and its affiliates ("JPMorgan Chase"), appreciates the opportunity to submit this response to the Board of Governors of the Federal Reserve System (the "Board") regarding its proposed changes to Regulation CC published on February 4, 2014 (the "Proposal").

JPMorgan Chase & Co. (NYSE: JPM) is a leading global financial services firm with assets of \$2.5 trillion and operations worldwide. The Firm is a leader in investment banking, financial services for consumers and small businesses, commercial banking, financial transaction processing, asset management and private equity. A component of the Dow Jones Industrial Average, JPMorgan Chase & Co. serves millions of consumers in the United States and many of the world's most prominent corporate, institutional and government clients under its J.P. Morgan and Chase brands. Information about JPMorgan Chase & Co. is available at www.jpmorganchase.com.

JPMorgan Chase supports the Board's continued efforts to facilitate the banking industry's ongoing transition to fully-electronic interbank check collection and return processing. JPMorgan Chase clears all check transactions electronically through clearing houses, direct exchange agreements or a Federal Reserve Bank (the "Federal Reserve"). For depositary banks that still require paper returned checks, JPMorgan Chase sends an electronic return file to a Federal Reserve, and the Federal Reserve creates and mails a substitute check to the depositary bank. Creating incentives for banks to accept electronic

returns and protecting paying banks from late return claims when a depository bank requires paper returns will help move the industry to fully electronic check processing and place the risk of loss for failure to accept electronic returns on the appropriate party. Modifying Regulation CC to extend its coverage of paper check exchange to include checks cleared through electronic check image exchange will provide a more consistent set of rules for the vast majority of participants receiving, presenting, clearing and returning electronic check images and related information through the United States check processing system.

As with our response to the Board's initial proposal in 2011, JPMorgan Chase worked with the Electronic Check Clearing House Organization ("ECCHO"), its member banks and other interested parties, to review and analyze the Proposal. JPMorgan Chase also participated in industry calls led by the American Bankers Association ("ABA") regarding the Proposal. JPMorgan Chase supports a majority of ECCHO's response to the Proposal which will be jointly submitted with other industry groups, including the ABA and The Clearing House ("ECCHO's Response").

I. Response to the Board's Overview

In its Overview of the Proposal, the Board highlights three main areas of change to Regulation CC: expeditious return requirements, the same-day settlement rule and the new warranties and indemnities related to electronic check processing.

A. Return Requirements: Expeditious Return and Notice of Non-payment. The Board provides two alternatives to the expeditious return and notice of non-payment requirements in an effort to move the industry to fully electronic return processing. The Proposal states that although the Federal Reserve estimates that over 99.9 percent of forward checks are cleared electronically, approximately three percent of check returns are still required to be processed as paper (i.e., the depository bank has not agreed to accept electronic returns or returns through the Federal Reserve's PDF Check Presentment and Return Service). We believe Alternative 1 does not create the right incentive for depository banks that still require paper returns to accept returns electronically. As stated in greater detail in ECCHO's Response, adopting Alternative 1 could result in slower processing of check returns if banks choose to move from electronic processing back to paper processing. Although more complex, Alternative 2 generally reflects the way most returns are processed today and JPMorgan Chase supports Alternative 2 over Alternative 1.

However, JPMorgan Chase strongly supports the recommendation in ECCHO's Response that the Board retain the "forward collection test." A paying bank may not have readily available or up-to-date information as to which depository banks do not accept electronic returns. The paying bank should not be penalized for its lack of knowledge about a depository bank's business decision to only accept paper return items. If the paying bank sends the return in an electronic format to a returning bank and that returning bank does not have an electronic return arrangement with the depository bank, there could be a delay in the depository bank's receipt of the return. In fairness, any loss from that delay should be born by the depository bank. The paying bank should be able to meet its expeditious return requirements if it sends an electronic return to a bank (acting as a returning bank) that the paying bank (when acting as a depository bank) would use to send a similar forward collection item to the depository bank (acting as a paying bank). The paying bank should be allowed to send the electronic return to this returning bank regardless of whether the returning bank has otherwise agreed to handle the electronic return expeditiously to the depository bank under the "2-day test" as established by Alternative 2. In such situations, the paying bank would continue to be protected from a claim of late return under Regulation CC by the depository bank.

JPMorgan Chase supports retaining the notice of non-payment requirement for returns; however, we recommend raising the threshold amount. Even in a fully electronic processing environment, there may be situations where a return may not reach the depository bank by 2:00p.m. of the second banking day. We believe that retaining the notice requirement but raising the amount (at least to \$10,000) would strike the right balance of providing an incentive to the depository banks to move to fully electronic processing while providing systemic fraud deterrents and a back-stop for larger dollar losses where there may be delay in a depository bank's receipt of the return.

B. Same-day Settlement Rule. The Board requests comment on whether (i) the paper same-day settlement ("SDS") rule should be eliminated and (ii) whether a new electronic SDS rule should be created. The Board reminds us in its Proposal that the paper SDS rule was established to reduce the competitive disparity of the Federal Reserve and the private-sector banks. The Federal Reserve has the ability to present checks to paying banks without paying a presentment fee and to obtain settlement by charging the paying bank's Federal Reserve account the same day. The paper SDS rule requires paying banks to designate presentment points that allow presenting banks to directly present to paying banks without a fee within a certain timeframe and receive same-day settlement. Because the current SDS rule

only applies to paper presentments and the vast majority of checks are now cleared through electronic check image processing, the competitive disadvantage between the private-sector banks and the Federal Reserve has reappeared. The Board asks whether the paper SDS rule should be retained to maintain a “balance of bargaining power, as well as reduce the competitive disparities between the Reserve Banks and private-sector banks.” JPMorgan Chase agrees that this is a concern; however, the paper SDS rule is no longer effective in creating a level playing field in the current electronic check image exchange environment. The Federal Reserve has the ability to charge fees to paying banks for electronic presentments when the private-sector collecting banks are unable to impose such fees on paying banks without an agreement.

As stated in our response to the Board's 2011 proposal, we continue to support an electronic SDS rule and recommend that Subsection 229.36(d)(2) and its *Commentary* clarify that the timeframes, deadlines, and settlement methods established for paper same-day settlement apply to same-day settlement of electronic collection items, (i.e., presenting bank cannot be charged a fee and the items must be presented by 8:00 am local time of the paying bank). The paying bank must make a reasonable effort to come to an agreement for electronic presentment of same-day settlement items. An agreement may be “deemed” to exist when a paying bank (a) has a direct agreement with the presenting bank for electronic collection items and has designated an electronic presentment point for same-day settlement, (b) has an agreement with a third party processor that processes electronic collection items for the presenting bank and has designated an electronic presentment point for same-day settlement, or (c) belongs to an image exchange network or collecting bank arrangement that makes its forward collection services for electronic collection items generally available to the presenting bank and such network or collecting bank processes electronic collection items on a same-day settlement basis. A paying bank cannot charge the presenting bank for the electronic connection between the paying bank and an intermediary acting as paying bank's processor with regard to (b) and (c) above. If an agreement cannot be achieved with the paying bank, an industry model agreement should be established and imposed or otherwise be deemed to apply absent a direct agreement.

If the Board determines that an electronic SDS rule is not feasible, then JPMorgan Chase supports retaining the paper SDS rule and strongly recommends that the Board address the competitive disadvantage in the current electronic exchange environment through other means such as waiving or

reducing presentment fees that the Federal Reserve may charge to paying banks for electronic presentments when the private sector collecting banks are unable to impose such fees on a paying bank without an agreement.

C. Framework for Electronic Checks and Electronic Returned Checks: Check-21-Like Warranties, Electrically Created Items Warranty and a Remote Deposit Capture Indemnity. JPMorgan Chase supports the Board's proposed definitions for Electronic Checks and Electronic Returned Checks as well as its proposal to apply the warranties in Subpart C (currently applicable to paper checks) to Electronic Checks and Electronic Returned Checks. We also support the new "Check-21-Like" warranties set forth in Subsection 229.34(a). As proposed, both warranties in Subsection 229.34(a) may be varied by agreement. The second warranty in Subsection 229.34(a)(1)(ii) provides: "[n]o person will receive a transfer, presentment or return of, or otherwise be charged for an electronic check or electronic returned check, the original check or a substitute check or a paper or electronic representation of a substitute check such that the person will be asked to make payment based on a check it has already paid." We feel this warranty regarding duplicate payment should not be allowed to be varied by agreement. The rationale for this position is that this warranty is meant to protect banks in situations where a truncating bank allows its deposit customer to use a remote deposit capture service, thereby retaining the ability to deposit the original check a second time. Further, the same warranty in Subpart D applicable only to substitute checks cannot be varied by agreement. Regulation J adopted a similar warranty applicable to electronic check image exchange and under Regulation J, the warranty cannot be varied by agreement. Therefore, we support this warranty in Subpart C; however, the rule should not allow variance of this warranty by agreement.

We support the Board's approach in creating an indemnity regarding Electronically Created Items ("ECIs"). Although not defined as checks, ECIs can be deposited and cleared through the check payment system without banks detecting that they are ECIs. Therefore, the Board's proposal to create an indemnity that protects receiving banks from losses associated with an item that is later determined to be an ECI creates certainty for the banks, and correctly places the risk of loss on the bank that introduces the ECI into the check payment system.

We also support the new indemnity to be provided by a truncating bank (a bank that offers its deposit customer a remote deposit capture service whereby the original paper check remains in the

possession of the deposit customer). In the Board's Proposal, a depositary bank that accepts the original paper check for deposit and receives a return due to the check having already been paid will be indemnified by the truncating bank. The truncating bank should assume the risk if their customer deposits the original paper check at another bank. This is a new indemnity is the only provision in Regulation CC that allows one depositary bank to make a claim directly against another depositary bank for the same check; therefore, we feel several additional provisions are needed. The indemnity should not be available if the original paper check is unauthorized, altered, presented by a person not entitled to enforce the check, or a counterfeit check. The depositary bank making the indemnity claim must establish that it was a holder of the original paper check at the time of deposit. When the paying bank returns the check to the depositary bank, the check and associated information does not identify the truncating bank. Therefore, the depositary bank seeking to make the indemnity claim will not be able to identify the truncating bank without obtaining certain information from the paying bank, including the bank that was paid for the check and when the check was paid. We recommend that the Board include an obligation of the paying bank to provide such information in a timely manner when requested by a depositary bank seeking to assert such claim. We also recommend that the rule provide a limited defense unless the depositary bank asserts such claim against the truncating bank within 30 days after it has reason to know of the breach and the identity of the warrantor (truncating bank). The depositary bank needs no additional information from its deposit customer and therefore should be obligated to make the claim in a timely manner similar to the provisions in Subsection 229.52(d) regarding the Check 21 warranty and Section 4-208 of the Uniform Commercial Code regarding presentment warranties.

II. Responses to the Board's Section by Section Changes in the Proposal

JPMorgan Chase's comments are limited to those Sections of the Proposal where we have additional comments or we have a different position than what is set forth in ECCHO's Response.

A. Subsection 229.2(dd) - Routing Number. JPMorgan Chase has actively participated in a working group with the Federal Reserve, the ABA, the ABA's agent responsible for assigning routing numbers to banks ("Accuity") and other financial institutions in a review of the rules and requirements relating to routing numbers. For various reasons, the routing number list has not accurately reflected active numbers used for payment transactions, especially check payments. As a result, fraudsters use retired

numbers on payment transactions, taking advantage of expedited funds availability requirements and the delay caused as banks try to determine the correct paying bank. After an extensive review of the historical practices and possible solutions, the working group recommends that the active routing list needs to be definitive and banks need to be held accountable for the routing numbers properly assigned to them by Accuity. Numbers that are reflected as retired pursuant to the ABA's Routing Number Policy should not be used. Banks should have the ability to rely on the active routing number list. The current definition of "routing number" in Regulation CC provides that it is a number assigned by the agent of the ABA and we request that the *Commentary* to the "routing number" definition clarify that any number that is a retired routing number or a number that has never been issued by the agent for the ABA is not a routing number for purposes of Regulation CC. This will create opportunities to identify fraudulent transactions more quickly and prevent losses before funds are made available to the depositor. In some situations it is the payor/drawer committing the fraud against an unsuspecting payee/depositor and by identifying the fraudulent transaction more quickly, the depositor may be protected from suffering a loss on the underlying transaction. Banks are in the business of clearing payments and, rather than return checks unpaid, checks with retired numbers may be outsourced for manual review which causes delay and potential "looping" if the check is then sent to a bank that may have previously been assigned the number but properly retired it with Accuity. Having the ability to rely on the active routing number list will allow participants in the deposit, clearing and return process the opportunity to reject the deposit of a check that does not contain an active routing number, place a hold on the deposit, reject presentment as a collecting bank, treat such check as a non-cash item, or as a paying bank, more quickly identify the invalid routing number, avoiding further manual review and delay in processing.

B. Subsection 229.2(vv) - MICR Line. JPMorgan Chase supports the effort underway by the industry standards group to create an identifier for a Remotely Created Check ("RCC") in the magnetic ink character recognition ("MICR") line of a check. We understand that some RCCs are created by a bank's deposit customer or the deposit customer's agent and therefore RCCs without the identifier could still enter the payment system undetected. However, banks have been unable to produce meaningful statistics on any RCC usage and we feel adding an RCC identifier capability will provide an opportunity to track RCC usage, at least in situations where the persons or entities creating the RCCs voluntarily use such identifier.

C. Subsection 229.31(e) Commentary on "Refer to Maker". The Board again asks for comments regarding "Refer to Maker" which is used as a return reason in certain circumstances. In support of ECCHO's Response, JPMorgan Chase agrees that specific return reasons should not be addressed in Regulation CC. Paying banks are under pressure to receive, process and return checks that will not be paid, within a very short timeframe. A paying bank should not be required to scrutinize every return for the best possible return reason or suffer liability even if the return itself is timely. In many situations, the paying bank will not have information readily available to it within the timeframe for expeditious return. The industry standards group is able to identify best practices and is flexible in adding new codes and removing old codes when return reasons change. All returns reasons should be left to the industry standards group and we support ECCHO's recommendation to remove the references to "Refer to Maker" from the *Commentary*.

D. Subsection 229.37 - Variation by Agreement. The Board requests comment on whether Regulation CC should prohibit variation by agreement regarding early receipt of electronic information with the check image to be delivered later. JPMorgan does not participate in such practices and is unaware of such practices by other banks. While we support variation by agreement for most sections of Subpart C, we feel the proposed warranty in Subsection 229.34(a)(1)(ii) should not be able to be varied by agreement.

E. Subsection 229.39 - Insolvency of Bank. In response to the Board's specific request for comment regarding Subsection 229.39(c), JPMorgan Chase supports maintaining a paying bank's preferred claim status when a presenting bank that breaches a warranty specified in Subsection 229.34(d)(1) or (3) with respect to checks for which the paying bank has settled if the presenting bank becomes insolvent before satisfying the warranty claim. Banks do not go through the normal bankruptcy process and the rules regarding bank insolvency and receivership are meant, in part, to create safety and stability of payments being processed through the United States payment system. Many check warranty claims are processed as "with entry" adjustments (financial settlement is automatically applied) through the Federal Reserve or pursuant to the ECCHO Rules. There is an expectation that payments related to the failed bank should be allowed to fully process, including payment of warranty claims on checks cleared prior to such bank's failure. To the extent that such adjustments can no longer be made while the bank is still operating but in receivership (or post-closure), such claims should be paid prior to other creditor claims.

III. Additional Comments

A. Evidentiary Presumption: Evidentiary Issue regarding Copies of Check Images. JPMorgan Chase appreciates the Board's consideration of this issue that was initially raised by The Clearing House on behalf of its member banks and JPMorgan Chase in response to the 2011 proposal. Although we are unaware of any additional litigation since our response to the 2011 proposal, we continue to support a rule in Regulation CC to remove the uncertainty of court decisions on this issue. A specific evidentiary issue related to the truncation and clearing of electronic collection items (or substitute checks) has arisen in check fraud law suits where only a copy of a check image, not the original check, is presented as evidence. The law currently allocates responsibility for the loss associated with check fraud between the paying bank and the depositary bank based on a determination of whether the original check was altered or whether the check was a counterfeit item. Prior to the rapid adoption of electronic check image exchange, the original check was presented as evidence and expert testimony based upon handwriting analysis and other forensic testing of the original check would be provided. Courts would use such testimony as a basis for determining liability. Because checks are now truncated and processed as either electronic collection items or substitute checks, copies of check images and not the original checks are provided as evidence without the referenced expert testimony. Courts presented with similar evidentiary issues have reached different conclusions on whether the check should be deemed to be an alteration of the original or a counterfeit. We believe the Board, through Regulation CC, should create an evidentiary presumption to remove this uncertainty. It is more appropriate that the presumption be that the original check was altered and not a counterfeit, placing the burden on the depositary bank to overcome such presumption, for the following reasons: (a) the paying bank does not have the right to demand presentment of the original check, (b) the vast majority of checks are truncated by the depositary banks or their customers, (c) the depositary bank has the option of retaining the original check, and (d) the depositary banks' customers received the funds related to the fraudulent check claim. We request the Board's further consideration of this issue and proposed solution.

B. Remotely Created Check Definition. Subsection 229.(fff) currently defines a "remotely created check" as a "check that is not created by a paying bank and that does not bear or purport to bear a signature applied, or purported to be applied, by a person on whose account the check is drawn." Subsection 229.34(d) sets forth the RCC warranty that "a bank that transfers or presents a Remotely

Created Check and receives settlement or other consideration warrants to the transferee bank, any subsequent collecting bank, and the paying bank that the person on whose account the Remotely Created Check is drawn authorized the issuance of the check in the amount stated on the check and the payee stated on the check." This RCC warranty shifts the loss from the paying bank to the depository bank and therefore, the warranty should only apply in situations where the payee or the payee's agent creates the check. In situations where the account owner instructs its own bill paying agent to create the check, the depository bank should not be held liable if the account owner later claims such check was not authorized. An RCC should contain language in the signature line stating "Authorization on File", "Account Owner Authorized this Check" or similar language.

JPMorgan Chase & Co. appreciates the opportunity to comment on these important changes to Regulation CC and welcomes any requests to discuss the points raised in our response. Should you have any questions, please contact Janice Havins at (713) 216 8070.

Sincerely,

A handwritten signature in cursive script, reading "Janice M. Havins". The signature is written in dark ink and is positioned above the printed name and title.

Janice M. Havins
Executive Director and
Assistant General Counsel